

The concept of CP's was originated in USA in early 19th century when commercial banks monopolized and charged high rate of interest on loans and advances. In India, the CP was launched in January 1990.

It is an unsecured money market instrument issued in the form of a promissory note. CP was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.

These are issued by corporate entities in denominations of Rs2.5mn and usually have a maturity of 90 days. CPs can also be issued for maturity periods of 180 and one year but the most active market is for 90 day CPs.

Two key regulations govern the issuance of CPs—firstly, CPs have to be compulsorily rated by a recognized credit rating agency and only those companies can issue CPs which have a short term rating of at least P1. Secondly, funds raised through CPs do not represent fresh borrowings for the corporate issuer but merely substitute a part of the banking limits available to it. Hence, a company issues CPs almost always to save on interest costs i.e. it will issue CPs only when the environment is such that CP issuance will be at rates lower than the rate at which it borrows money from its banking consortium.

Who can issue Commercial Paper (CP)

Highly rated corporate borrowers, primary dealers (PDs) and satellite dealers (SDs) and all-India financial institutions (FIs) which have been permitted to raise resources through money market instruments under the umbrella limit fixed by Reserve Bank of India are eligible to issue CP.

A company shall be eligible to issue CP provided – (a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore; (b) the working capital (fund-based) limit of the company from the banking system is not less than Rs.4 crore and (c) the borrowal account of the company is classified as a Standard Asset by the financing bank/s.

Commercial Papers when issued in Physical Form are negotiable by endorsement and delivery and hence highly flexible instruments.

Rating Requirement

All eligible participants should obtain the credit rating for issuance of Commercial Paper, from either the Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the Duff & Phelps Credit Rating India Pvt. Ltd. (DCR India) or such other credit rating agency as may be specified by the Reserve Bank of India from time to time, for the purpose. The minimum credit rating shall be P-2 of CRISIL or such equivalent rating by other agencies. Further, the participants shall ensure at the time of issuance of CP that the rating so obtained is current and has not fallen due for review.

Maturity

CP can be issued for maturities between a minimum of 15 days and a maximum upto one year from the date of issue. If the maturity date is a holiday, the company would be liable to make payment on the immediate preceding working day.

Denominations

CP can be issued in denominations of Rs.5 lakh or multiples thereof.

Investment in CP

CP may be issued to and held by individuals, banking companies, insurance companies, other corporate bodies registered or incorporated in India and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs). However, investment by FIIs would be within the 30 per cent limit set for their investments in debt instruments. Non resident Indians can invest in CP's on a non repatriable, non transferable basis.

Trading

Trading is Over-the-counter or on the NSE. Market participants quote dealing levels on yield basis specified up to two decimal places. For quotes on the NSE equivalent prices up to 4 decimal prices need to be specified. Two way quotes are rarely offered for Commercial Paper. Secondary market transactions do not attract any stamp duty. There are no brokers in the Commercial Paper market. Trading is done over the counter with the counterparties involved.

Mode of Issuance

CP can be issued either in the form of a promissory note or in a dematerialised form through any of the depositories approved by and registered with SEBI. As regards the existing stock of CP, the same can continue to be held either in physical form or can be dematerialised, if both the issuer, and the investor agree for the same.

How payment is received and made for CP

The initial investor in CP shall pay the discounted value of the CP by means of a crossed account payee cheque to the account of the issuer through IPA(Issuing and Paying Agent). On maturity of CP, when the CP is held in physical form, the holder of the CP shall present the instrument for payment to the issuer through the IPA. However; when the CP is held in demat form, the holder of the CP will have to get it redeemed through depository and receive payment from the IPA.

What is the procedure of issuing CP

Every issuer must appoint an IPA for issuance of CP. The issuer should disclose to the potential investors its financial position as per the standard market practice. After the exchange of deal confirmation between the investor and the issuer, issuing company shall issue physical certificates to the investor or arrange for crediting the CP to the investor's account with a depository. Investors shall be given a copy of IPA certificate to the effect that the issuer has a valid agreement with the IPA and documents are in order

Coupon Terms

CP will be issued at a discount to face value as may be determined by the issuer and redeemable at par on maturity.

Risks Involved

Liquidity risk : This risk is managed by laying down deal size limits for the dealers, heads of desk and heads of groups.

Credit risk : This risk is managed by laying down counterparty limits based upon the financial strength of the counterparty.

Operational risk : The risk involved in the operations of the issuer.

Taxation

The CBDT vide circular no 647 dated 22nd March 1993 has clarified that the difference between the issue price and the face value of the Commercial Papers and the Certificates of Deposits is to be treated as 'discount allowed' and not as 'Interest paid'. Hence, the provisions of the Income-tax Act relating to deduction of tax at source are not applicable in the case of transactions in these two instruments.

1. What is Commercial Paper (CP) ?

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note.

2. When it was introduced?

It was introduced in India in 1990.

3. Why it was introduced?

It was introduced in India in 1990 with a view to enabling highly rated corporate borrowers/ to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, primary dealers and satellite dealers were also permitted to issue CP to enable them to meet their short-term funding requirements for their operations.

4. Who can issue CP?

Corporates, primary dealers (PDs) and the All-India Financial Institutions (FIs) are eligible to issue CP.

5. Whether all the corporates would automatically be eligible to issue CP

No. A corporate would be eligible to issue CP provided –

- a. the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore
- b. company has been sanctioned working capital limit by bank/s or all-India financial institution/s; and
- c. the borrowal account of the company is classified as a Standard Asset by the financing bank/s/ institution/s.

6 Is there any rating requirement for issuance of CP? And if so, what is the rating requirement?

Yes. All eligible participants shall obtain the credit rating for issuance of Commercial Paper either from Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit rating agency (CRA) as may be specified by the Reserve Bank of India from time to time, for the purpose.

The minimum credit rating shall be P-2 of CRISIL or such equivalent rating by other agencies.

The issuers shall ensure at the time of issuance of CP that the rating so obtained is current and has not fallen due for review and the maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid.

7 What is the minimum and maximum period of maturity prescribed for CP?

CP can be issued for maturities between a minimum of 15 days and a maximum up to one year from the date of issue.

8 What is the limit up to which a CP can be issued.

The aggregate amount of CP from an issuer shall be within the limit as approved by its Board of Directors or the quantum indicated by the Credit Rating Agency for the specified rating, whichever is lower.

As regards FIs, they can issue CP within the overall umbrella limit fixed by the RBI i.e., issue of CP together with other instruments viz., term money borrowings, term deposits, certificates of deposit and inter-corporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

9. In what denominations a CP that can be issued?

CP can be issued in denominations of Rs.5 lakh or multiples thereof.

10. How long the CP issue can remain open?

The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription.

11. Whether CP can be issued on different dates by the same issuer?

Yes. CP may be issued on a single date or in parts on different dates provided that in the latter case, each CP shall have the same maturity date. Further, every issue of CP, including renewal, shall be treated as a fresh issue.

12. Who can act as Issuing and Paying Agent (IPA) ?

Only a scheduled bank can act as an IPA for issuance of CP.

13. Who can invest in CP?

Individuals, banking companies, other corporate bodies registered or incorporated in India and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs) etc. can invest in CPs. However, amount invested by single investor should not be less than Rs.5 lakh (face value).

However, investment by FIIs would be within the limits set for their investments by Securities and Exchange Board of India (SEBI).

14. Whether CP can be held in dematerialised form?

Yes. CP can be issued either in the form of a promissory note (Schedule I) or in a dematerialised form through any of the depositories approved by and registered with SEBI. Banks, FIs, PDs and SDs are directed to hold CP only in dematerialised form.

15. Whether CP is always issued at a discount?

Yes. CP will be issued at a discount to face value as may be determined by the issuer.

16. Whether CP can be underwritten?

No issuer shall have the issue of Commercial Paper underwritten or co-accepted.

17. What is the mode of redemption?

Initially the investor in CP is required to pay only the discounted value of the CP by means of a crossed account payee cheque to the account of the issuer through IPA. On maturity of CP,

(a) when the CP is held in physical form, the holder of the CP shall present the instrument for payment to the issuer through the IPA.

(b) when the CP is held in demat form, the holder of the CP will have to get it redeemed through the depository and receive payment from the IPA.

18. Whether Stand by facility is required to be provided by the bankers/FIs for CP issue?

CP being a 'stand alone' product, it would not be obligatory in any manner on the part of banks and FIs to provide stand-by facility to the issuers of CP.

However, Banks and FIs have the flexibility to provide for a CP issue, credit enhancement by way of stand-by assistance/credit backstop facility, etc., based on their commercial judgement and as per terms prescribed by them. This will be subjected to prudential norms as applicable and subject to specific approval of the Board.

19. Whether non-bank entities/corporates can provide guarantee for credit enhancement of the CP issue.

Yes. Non-bank entities including corporates can provide unconditional and irrevocable guarantee for credit enhancement for CP issue provided :

- a. the issuer fulfils the eligibility criteria prescribed for issuance of CP;
- b. the guarantor has a credit rating at least one notch higher than the issuer by an approved credit rating agency and
- c. the offer document for CP properly discloses: the networth of the guarantor company, the names of the companies to which the guarantor has issued similar guarantees, the extent of the guarantees offered by the guarantor company, and the conditions under which the guarantee will be invoked.

20. Role and responsibilities of the Issuer/Issuing and Paying Agent and Credit Rating Agency

Issuer:

- a. Every issuer must appoint an IPA for issuance of CP.
- b. The issuer should disclose to the potential investors its financial position as per the standard market practice.
- c. After the exchange of deal confirmation between the investor and the issuer, issuing company shall issue physical certificates to the investor or arrange for crediting the CP to the investor's account with a depository.

Investors shall be given a copy of IPA certificate to the effect that the issuer has a valid agreement with the IPA and documents are in order (Schedule III).

Issuing and Paying Agent

- a. IPA would ensure that issuer has the minimum credit rating as stipulated by the RBI and amount mobilised through issuance of CP is within the quantum indicated by CRA for the specified rating.
- b. IPA has to verify all the documents submitted by the issuer viz., copy of board resolution, signatures of authorised executants (when CP in physical form) and issue a certificate that documents are in order. It should also certify that it has a valid agreement with the issuer (Schedule III).
- c. Certified copies of original documents verified by the IPA should be held in the custody of IPA.

Credit Rating Agency

- a. Code of Conduct prescribed by the SEBI for CRAs for undertaking rating of capital market instruments shall be applicable to them (CRAs) for rating CP.
- b. Further, the credit rating agency have the discretion to determine the validity period of the rating depending upon its perception about the strength of the issuer. Accordingly, CRA shall at the time of rating, clearly indicate the date when the rating is due for review.
- c. While the CRAs can decide the validity period of credit rating, CRAs would have to closely monitor the rating assigned to issuers vis-a-vis their track record at regular intervals and would be required to make its revision in the ratings public through its publications and website

21. Is there any other formalities and reporting requirement with regard to CP issue.

Fixed Income Money Market and Derivatives Association of India (FIMMDA), as a self-regulatory organisation (SRO) for the fixed income money market securities, may prescribe, in consultation with the RBI, any standardised procedure and documentation for operational flexibility and smooth functioning of CP market. Every CP issue should be reported to the Chief General Manager, Industrial and Export Credit Department (IECD), Reserve Bank of India, Central Office, Mumbai through the Issuing and Paying Agent (IPA) within three days from the date of completion of the issue, incorporating details as per Schedule II.